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TAGS: EFIN ECON BE
SUBJECT: BELGIUM AND THE FINANCIAL CRISIS: THE LAST BANK STANDING

Classified By: POL/ECON Counselor Richard Eason, Reasons 1.4 (b) and (d).

¶1. (C) SUMMARY: Over the past six weeks, Belgium has had its top two banks either dismembered or transformed nearly beyond recognition. The final Belgian bank, too, was just given a government rescue package. The saga of how this happened points to failings in bank management, mis-steps and mis-statements by government regulators, internal political haggling, and, from the Belgian perspective, unhelpful actions from the Dutch. The political repercussions of these seismic changes in Belgium's financial sector will likely play out for months to come, at least through the run-up to important regional elections being held in June 2009. There is surely little glory to be found anywhere in this story.
END SUMMARY.

FORTIS LITERALLY ON THE CHOPPING BLOCK

¶2. (C) Peter Praet (please protect), the Director of the National Bank of Belgium (the country's central bank) gave POL/ECOUNS the background on the nearly herculean struggles the government of Belgium has gone through over the past six weeks in order to prevent a major collapse in the country's financial system. Belgium has been one of the countries hardest hit by the global financial crisis, with all of its three top banks needing emergency attention and only one still in roughly the same form from before the crisis began.

¶3. (C) According to Praet, in late September when it became clear that Fortis, Belgium's largest bank, was in serious difficulty, Fortis attempted to sell the ABN-AMRO assets it had acquired a year ago to Deutsche Bank. However, this attempt was blocked by Dutch authorities on the grounds, according to one Dutch official, that Fortis was trying to "put a German elephant in the Dutch bed." Praet believes that the Dutch have no interest in letting large German banks have a major presence in their banking sector and also were eager to reacquire the assets of ABN-AMRO.

¶4. (C) At the same time, the Belgian authorities were worried about a run on the bank at Fortis. Although two "queues" at Fortis branches in a suburb of Brussels raised concerns, the real fear was that the run would take place via internet withdrawals. The Belgians then held a series of meetings with ECB President Jean-Claude Trichet, Dutch Finance Minister Wouter Bos, French Finance Minister Christine Lagarde, and the heads of ING, BNP and Fortis.

¶5. (C) Praet said that in internal discussions he had told the other Belgian officials present that the time for political haggling was over as this was war, a war to restore the stability of Belgium's financial system. In the subsequent negotiations Fortis CEO Michel Tilmant was

described as being very unhelpful, seeking small gains for Fortis which threatened to sink the entire deal. Tilmant's management of Fortis was heavily criticized by many quarters, including within the government. By September 28, Trichet expressed his fears that a collapse of Fortis could affect the entire financial system of the European Union, in a way similar to the impact of the collapse of Lehman Brothers.

¶6. (C) Over the course of a weekend, Belgium, Luxembourg and the Netherlands agreed on a bailout of Fortis. Despite the agreement, the Dutch government did not provide the 4 billion euros promised on September 28. In addition, the NBB was forced to transfer 46 billion euros to Fortis Netherlands to protect its solvency. Praet was uncertain as to why this had not been provided by Nederlandse Bank. The following day the ECB provided Fortis with 15 billion euros in Emergency Liquidity Assistance (ELA) and another 30 billion euros the following day. Dutch officials return to Brussels with spreadsheets showing that a split-up of Fortis was inevitable and threatened to withdraw the banking license for Fortis Netherlands on October 2. The Belgians were taken completely by surprise. The Dutch further demanded to take over the Belgian insurance portfolio of Fortis. Belgium is able to extend the deadline set by the Dutch to October 3. However, Bos then made a public statement to the effect that all the toxic debt was in the Belgian parts of Fortis, causing most Belgian bank shares to plunge.

¶7. (C) Belgium was left with no options. The Dutch were able to recover the parts of ABN-AMRO that had been sold to Fortis a year ago. BNP then purchased 75% of the remaining parts of Fortis for $11.3 billion. As Praet said, Fortis

suffered from weak management but the break-up of Fortis caused a huge loss of wealth for Belgium. The Belgians had sought an agreement by the Dutch to share the proceeds of the Fortis Netherlands assets were sold at a future date for a profit but been given a blunt "No."

8 (C) According to Praet, Fortis continues to bleed assets and BNP Paribas still needs to make up shortfalls in its daily operations. Significant lay-offs at Fortis are unavoidable.

NEXT UP, DEXIA...

¶9. (C) Praet said the impact of the bail-out of Dexia will also take time to play out. One immediate impact is that the French communes (for which Dexia provides much of their routine financing) will face increased spreads. The U.S. monoline company, FSA, remains an area of concern. It remains unclear whether the Paulson plan will cover FSA losses. The status of FSA itself within Dexia remains an issue. The Belgians view it as a French responsibility because the French arm of Dexia acquired FSA; the French see it as a Belgian problem.

¶10. (C) The nature of the deal itself changed substantially over the course of the crisis. The French government initially said Dexia was merely a Belgian problem, until it realized that Dexia finances many of the municipal governments in France, as it also does in Belgium. Belgium was initially going to cover 80% of the capital injection into the bank, with France injecting 20%. Under pressure from its other commitments, the Belgian government had to reduce its share to 75%.

¶11. (C) Belgian authorities were critical of Dexia management as well, describing it as having a "bloated structure." Former CEO Axel Miller also came under severe criticism. Praet believes that, with the FSA issue still unresolved, there remains a real possibility that Dexia could also be broken up along the lines of Fortis.

KBC--WHEN GOOD MANAGEMENT IS NOT ENOUGH

¶12. (C) NBB Governor Quaden was not directly involved in negotiating any of the bailout packages. At one point after the Fortis and Dexia deals, he publicly stated that "any sound bank can go down," leading immediately to a panic that caused a severe drop in the share price of KBC, the last remaining large mainly-Belgian bank. Praet said that KBC was a well-managed bank but that the market was now suspicious of any bank lacking either capital injections or government guarantees. The Belgian families behind the bank did not want to inject more capital so the government was forced to fill the gap with its 3.5 billion euro package. In exchange, the government gets two seats on the board and the bank agrees to cancel the 2008 dividend, saving 1.3 billion euros. KBC has the authority to buy out the Belgian government at 150 percent of the current share price provided the Belgian Banking Commission approves the sale.

COMMENT

¶13. (C) Belgium's banking sector has been totally transformed by this financial crisis. As Praet said, there has been a tremendous loss of wealth in the country. Inevitably, substantial job losses lie ahead as well. Belgium's banks have demonstrated that a cozy relationship with the country's elites cannot compensate for poor management or sheer bad luck. Unfortunately, the many average Belgians who were also lifelong shareholders in these banks will also suffer. Court cases against Fortis are already being filed on a daily basis and are expected to continue.

¶14. (C) In addition to the substantial loss of prestige, the country will now face the political fall-out. There is already sniping even within the governing coalition, with the francophone socialists using the crisis to criticize both the Christian Democrats and to pressure their main rivals in Wallonia, the francophone liberals, the party of Didier Reynders, the current and long-serving Finance Minister. The crisis will certainly give the socialists ammunition for the political battles ahead as they jockey to try to improve their vote totals in the June 2009 regional elections. The

only good thing about the financial crisis is that hardly anyone is now talking about the long-standing political crisis any more, with fears about lifetime savings easily trumping intra-regional tax transfers and redistricting in the mind of voters.

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